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October 25, 1996

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, DC 20554

Re: CS Docket No. 96-60
Ex Parte Presentation

Dear Mr. Caton:

On behalf of ValueVision International, Inc. ("ValueVision"), and pursuant to Section 1.1206 of the Commission's rules, this notice is filed in duplicate to notify the Commission that on October 24, 1996, representatives of ValueVision met with James Coltharp to discuss the matters raised in the attached materials.

If there are any questions concerning the above-referenced matter, please communicate with the undersigned.

Sincerely yours,

William R. Richardson, Jr.

cc: James Coltharp

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WHY IMPLICIT FEE PROPOSALS ARE FATALLY FLAWED

1. Implicit fee calculations cannot be imported from the premium channel to the tier context, because they cannot accurately measure the value to a subscriber of any particular channel on that tier.

a. The original Besen implicit fee proposal was not applied to tiers.

b. The Commission advanced no basis for its 1993 view that "where necessary to determine the value to a subscriber of a single channel on a tier, the rate calculation . . . contemplates <u>dividing the cost of the total tier by the number of channels located on that tier</u>." 8 FCC Rcd at 5950-51 n.1312.

c. This approach assumes that each channel has the same value to a subscriber, even though Lifetime has a 1.4 rating and E! has a 0.3 rating. Multichannel News, July 1, 1996, at 8. And it forces the leased access programmer to pay the average even though (as with must carry) the operator is obviously going to replace underperformers rather than average performers.

2. To add insult to injury, the operator recovers not only this inflated measure of the value of the channel bumped, but all of the subscriber revenues attributable to carriage of the channel. This double income stream is in sharp contrast to OVS, where the program packager can put together its own tier and collect the revenues for that leased tier directly from subscribers.

3. NCTA claims that the implicit fee is a "surrogate" for the completely unproven possibility that replacing low rated cable channels with new leased access programmers will result in lost subscribers.

a. While this possibility is highly remote, the implicit fee is in any event a measure with absolutely no logical connection to the anticipated size of any such subscriber loss.

b. In fact, if the average implicit fee works out to a 35-40 cents per sub per month rate, and the cost/market formula works out to 5-10 cents, then the 30 cents differential works out to an assumption of a 5% drop in subscribers for each leased channel substituted on a CPST tier (assuming $14 CPST price and 40% EBITDA margin). Given the very low ratings of the least popular cable channels, this is preposterous.

c. Indeed, the Commission's own "going forward" regime indicates that newly added channels are valued by subscribers at no more than 20 cents each (plus programming costs, which would be netted out in an implicit fee calculation).

4. The only real loss for which NCTA seeks recovery is not an economic loss at all. It is a 10-15% loss of the operator's "right to freely program [a] channel."[1] Congress, however, instead applied common carrier principles to the leased access set aside. And as the Fox-TCI-Lifetime dispute shows, it is by no means obvious that the exercise of that right by a monopolist maximizes consumer welfare.

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[1] Ex Parte Presentation of NCTA (Sept. 17, 1996); Comments of NCTA at 19 ("taking away an operator's ability to program a channel").

WHY LOST SUBSCRIBER REVENUE IS A MYTH

1. As a threshold matter, the only reliable record evidence on this point is ValueVision's October 2 letter providing anecdotal evidence that such loss appears to be nil.

2. The cable industry knows the answer and has provided virtually no evidence on this point, apart from push-pull "surveys" that lack any credibility. In OVS, the burden shifts to the operator in the absence of proof that the channels are being leased. Here, however, NCTA says only that lost subscriber revenue is "difficult to quantify" (Comments at 14) and therefore the Commission must presume it without proof.

3. True, operators provide evidence that some channels would have a negative opportunity cost under the Commission's formula. But the opportunity cost is not calculated by reference to channels (such as ESPN) that will <u>remain</u> on the system. And in any event, the existence of a negative opportunity cost does not demonstrate that such channels are being carried for their popularity, much less that subscribers would terminate if these channels were replaced with others.

a. Many of these are vertically integrated programmers. NCTA's comments concede that over 2/3 of the top 25 cable networks (in terms of carriage) are vertically integrated. Cable channels are carried largely because of strategic relationships between operator and programmer -- and dropped because of the absence of such relationships (<u>e.g.</u>, MEU).

b. Carrying these channels now enables operators to increase rates -- by at least 20 cents plus programming costs.

c. Negative rates for leased access would never materialize. They would quickly generate an auction market.

HOW TO MAKE SENSE OUT OF THE LEGISLATIVE HISTORY

1. The 1984 Act did not regulate leased access rates. But it did intend that operators provide rates designed "to encourage, and not discourage, use of [leased access] channels." H.R. Rep. No. 934, 98th Cong., 2d Sess. 51 (1984).

2. In requiring leased access, the 1984 Act did provide that rates should be sufficient not to adversely affect "the operation, financial condition, or market development of the cable system." But that proviso was to be read "consistent with the purpose" of leased access. 47 U.S.C. § 532(c). And it certainly did not mean that Congress intended for the cable industry to <u>increase</u> its 1984 profitability while preventing leased access, and then later claim that it had a statutory entitlement to <u>continue</u> such monopoly rents.

3. The whole premise of the 1992 Act was that cable operators had obtained monopoly status and earned monopoly profits that required reregulation. As Congress noted, monthly subscriber revenue increased from $18.94 in 1984 to $31.51 in 1991 and annual cable advertising revenues increased five-fold. H.R. Rep. No. 628, 102d Cong., 2d Sess. 29 (1992). Cable industry cash flow increased from $4.8 billion in 1987 to $9.7 billion in 1992. 9 FCC Rcd at 7570; 11 FCC Rcd at 2163.

4. Thus, the 1992 Congress hardly was intending to preserve monopoly rents. In fact, the intent of the 1992 revisions to the 1984 Act on leased access was to direct the Commission to <u>change</u> the rates for leased access so as to make it a genuine outlet. And "the principal reason" for its not being one was the power of cable operators "to establish the price and conditions for use." H.R. Rep. 628 at 39.

5. In 1992, Congress amended the "adversely affect" proviso to add that rates must also be consistent "with rules prescribed by the Commission." And "[w]hen Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect." <u>Stone v. INS</u>, 115 S. Ct. 1537, 1545 (1995).

6. The 1996 Act legislative history reflects that Congress <u>rejected</u> attempts to eliminate leased access obligations. <u>See</u> Reply Comments of ValueVision at 6, citing H.R. Rep. No. 204, Part I, 104th Cong., 1st Sess. 115-16 (1995)(proposing to add §§ 653(b)(2) & (d)).